

CHAPTER 4: CONDUCTING NEGOTIATIONS

Learning Objectives

In this chapter you will learn:

Primary Learning Objective (PLO)

Conduct government contract negotiations.

Classroom Learning Objective 4/1

Prepare the negotiation environment.

Classroom Learning Objective 4/2

Negotiate.

Classroom Learning Objective 4/3

Prepare the Price Negotiation Memorandum (PNM).

Contents and Procedures

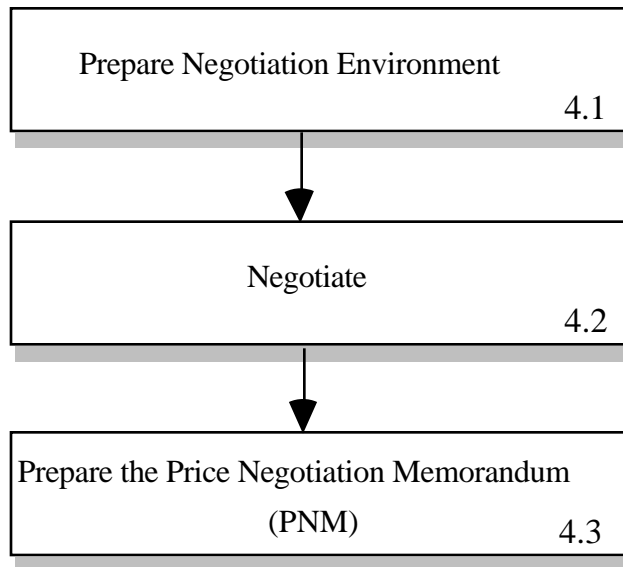
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Procedural Steps

The following flowchart outlines the information presented in this chapter:



4.0 Introduction

**Negotiation
Phase**

The negotiation stage of the government contract process is the phase in which the actual bargaining with the contractor is conducted. The length of the negotiation varies for each contract, from a single conference to many bargaining sessions stretching over days and even weeks. The time needed to negotiate depends on the complexity of contract, number of issues, and differences between the two parties, as well as the personalities and styles of the individual negotiators.

**Chapter
Context**

The negotiations discussed in this chapter include only sole source contracts. Much of the material is also applicable to competitive discussions, which are not included here, but are covered in Chapter 8.

4.1 Prepare the Negotiation Environment

Introduction

Achieving win/win outcomes should be the paramount priority for most government contract negotiations and the negotiation environment can aid the attainment of these desired outcomes. The physical and psychological atmosphere surrounding the bargaining session can have an important impact on the type of outcome perceived by each side.

Prepare the Physical Environment

The government usually hosts the bargaining session. When it does, it then has the responsibility for providing the facilities in which a negotiation can be conducted. In preparing the facilities, remember that the physical arrangements should facilitate win/win outcomes and that your side is "selling" a position. Consequently, the physical environment should enhance these overriding themes by giving the other side the perception they are being treated fairly and with respect. Although the physical environment also conveys many important nonverbal messages which will be discussed in Chapter 7, some important things to consider are:

- Conduct the negotiation in a room with sufficient comfort for both sides, to include adequate furnishings, lighting, and space for each side. Ensuring a comfortable room temperature is also important. Physical discomfort may negatively affect the attitudes of people already under negotiating pressure who often perceive discomfort as a win/lose tactic by the host side.
 - Conference table(s) large enough to comfortably seat all members of both teams with adequate space for their work papers, reference material, and briefcases should be provided. Depending upon the complexity of and probable length of the negotiation, more chairs may be needed if specialists or observers are added to the group. However, any additional furniture should be positioned so as not to interfere with the action at the negotiation table.
 - Try to arrange for nearby caucus rooms that could be available for confidential conferences to allow each side privacy during recesses for solving problems and re-examining positions.
 - Provide necessary visual aids support for both negotiating teams. This may include overhead projectors, VCR/TV, and display charts. White boards and chalkboards are especially useful during price negotiations. Good visual aids for presenting facts and historical data that both sides agree on is generally beneficial to negotiations.
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Rebrief Team Members

Brief team members immediately prior to negotiations on their individual roles during the bargaining session and review the important points of the kickoff briefing (see Chapter 3).

Be prompt. The government team members should arrive on time --in fact, preferably before the team members from the other side.

Since successful negotiations are founded on mutual respect between the parties, personal appearance is important. The team leader, along with each team member

should ensure that everyone on the government team presents a neat and well-groomed appearance. The importance of personal appearance will be discussed in greater detail in Chapter 7.

4.2 Negotiate

Introduction

Conducting negotiations can be broken down into 7 tasks:

- (1) Opening
 - (2) Factfinding
 - (3) Discussing Issues
 - (4) Reaching Agreements
 - (5) Managing the Team
 - (6) Taking Breaks/Caucus
 - (7) Closing
-

Task 1: Opening

The opening of the conference is critical because it sets the stage for the rest of the negotiations. The manner of the opening can influence attitudes that will prevail throughout the conference and can either aid or detract from a win/win agreement.

The government team leader is responsible for opening the conference with a statement and presenting the agenda. The opening statement generally consists of background information to facilitate mutual understanding. Since the conference opening should be planned beforehand, the following suggestions should be considered.

- Extend a firm handshake and cordial greeting to everyone while expressing appreciation for the contractor's interest in obtaining the government contract (see Chapter 7) .
 - Introduce government team members by their full names, titles or positions. To help both sides remember each others' names, consider providing an attendance roster or nameplates for all team members at the conference table. If the nameplates have been prepositioned on the table, allow time for the contractor side to rearrange the seating in accordance with their seating preference.
 - Strive to dispel the tension present at every negotiation. Casual conversation often reduces tension and helps conferees feel at ease. But most importantly, emphasize the government's interest in fairness and a win/win outcome. Ask the other side to maintain an objective attitude and solicit their sincere cooperation.
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Task 2: Factfinding

After the opening remarks, the chief negotiator should not delve immediately into the major issues of the negotiation. Instead, the first order of business should generally be to ensure that both parties have the same understanding of:

- The work to be done
- Government terms and conditions for performing the work
- Exceptions to those terms and conditions proposed by the contractor
- Facts, assumptions, and judgments submitted by the contractor to support its proposal

If factfinding preceded the formal negotiation conference, summarize the results of the session. Then allow time for any further factfinding that either party may feel is necessary. Also remember that factfinding does not necessarily end once the actual bargaining begins. Continued factfinding is often necessary because both parties often dispute the assumptions and judgments of the other side.

If factfinding has been scheduled or if there has been no factfinding at all prior to this point proceed with the factfinding session — observing the rules for factfinding discussed in Chapter 2.

**Task 3:
Discussing
Issues**

The government should maintain the initiative throughout the discussions by controlling the agenda, asking the questions, and holding to the negotiation plan. However, the government side also needs to be flexible by adjusting to the negotiation methods of the contractor side. For example, the government side may need to employ tactics or countermeasures to achieve the desired win/win outcome when the tactics displayed by the contractor side demonstrate a win/lose negotiating style.

Remember to actively listen to what the other side is saying. Since you have two ears and one mouth, listen to what is being said twice as often as you talk. Listening will minimize the probability of misunderstanding and also show you have a genuine interest in what the other side is saying.

**Contract
Requirements**

Discussions generally begin with both parties seeking agreement on the contract requirements and the related aspects of the Contract Schedule (Sections A through H of the Uniform Contract Format). Until there is a meeting of the minds on all contract characteristics, negotiations on contract price cannot proceed.

When discussing technical issues, always be mindful of the potential impact on price. Remember that every contract requirement, such as the specifications or delivery schedule, can dramatically increase contract costs. For this reason, do not get boxed into a high price by prematurely agreeing with recommendations for "gold plating" the deliverable.

Nevertheless, there may be reasons for revisiting the schedule after agreement has been reached and price negotiations have started. Earlier agreements are always negotiable until a final settlement on contract price has been reached. For instance, the agreed upon delivery schedule could be changed by mutual agreement if the contractor would agree on a lower price in exchange for a different delivery schedule.

Contract Price

The basic way for the government to negotiate price depends on whether the contractor offer is below or above the lowest government estimate of a fair and reasonable price consistent with a win/win outcome. (NOTE: For certain contract types, other contract price issues are also negotiated. For example, when negotiating fixed price incentive firm contracts, agreement must be obtained on the ceiling price and share ratios.)

Negotiating Low Offers

FAR 15.607

FAR 9.103(c)

When the contractor has proposed a price that is significantly below the minimum government position on what constitutes a fair and reasonable price, the government should treat the offer as a potential "mistake" under FAR 15.607. The thrust of the negotiations then may be to determine whether or not the contractor can be considered responsible at that price. FAR 9.103(c) stresses that "the award of a contract to a supplier based on lowest evaluated price alone can be false economy if there is subsequent default, late deliveries, or other unsatisfactory performance resulting in additional contractual or administrative costs."

FAR 15.608

FAR 15.608 also stresses that the purpose of price or cost analysis is "not only to determine whether [the offered price] is reasonable, but also to determine the contractor's understanding of the work and ability to perform the contract." When negotiating a low offer, these issues may become paramount. Sometimes, the contractor side will discover that there is more to the work than they had anticipated, in which case a higher priced offer may be submitted. If the contractor successfully demonstrates that the work can and will be satisfactorily performed at the offered price, then you may award at that price even if the contractor knows that a profit will probably not be achievable at that price.

Negotiating High Offers

In sole source negotiations, the proposed price is usually significantly higher than the government minimum. How the government negotiates with the contractor to lower that price depends on whether certified data on contractor costs is available. Since the contractor may have valid reasons to demonstrate that its initial proposed price is more reasonable than the government position, in a true win/win spirit never completely rule out that possibility and insist on a price reduction.

If the contractor has submitted cost data, the negotiations should generally be conducted in the following order:

- The proposed work design (i.e., the work breakdown structure).
- Direct costs (i.e., materials, labor, and other) of performing the work.
- Indirect costs, such as overhead and general and administrative costs.
- Profit or fee.
- The overall contract price.

Do not become preoccupied with any single element of cost by insisting on reaching agreement on every cost element. The government goal should be to achieve a mutual agreement on an overall price that is fair and reasonable.

When negotiating on the basis of price analysis alone (with no accompanying cost analysis), use the following method of persuasion to reach agreement on a lower price. First, present the reasons for believing that the offered price is too high, such as historical prices, other commercial prices or the government estimate. Next, place the burden on the contractor to prove that the offered price is reasonable and fair to both parties, e.g., by volunteering limited or partial cost data.

**Task 4:
Reaching
Agreements**

Begin by identifying and laying aside those issues on which the government agrees with the contractor position. Next, attempt to resolve the remaining issues to your mutual benefit. When differences cannot be resolved, pursue agreement through the give and take of bargaining by trading "gains" for "losses."

**Sequencing
Areas of
Disagreement**

There are different schools of thought on the best sequence for negotiating areas of disagreement. One school believes it is better to start by negotiating those issues that are of greatest importance and then discuss the less important issues. As each issue comes up, try to reach agreement. When agreement cannot be reached, lay the issue aside and move on to the next. Once you begin discussing issues of secondary importance, you can trade these secondary issues for the more important unresolved issues.

Another school of thought believes it is best to start negotiating on secondary issues first. Because secondary issues are often easier to agree on, this approach creates a climate of success and mutual cooperation. Advocates of this approach feel that the favorable climate makes it easier to reach agreement on the more important issues.

Finally, a third school of thought suggests that the government negotiate the contractor demands first. According to this approach, by first making concessions on items important to the contractor, the government side creates a win/win environment and is then more likely to receive comparable concessions from the contractor side.

No one approach is necessarily better than another. The issues being negotiated, circumstances surrounding the negotiation, and the negotiating styles of the negotiator determine the method most likely to succeed. Moreover, predictable patterns may not even be desirable when regularly negotiating with the same party.

**Agreement
Through
Mutual
Problem-
Solving**

The initial approach to resolving areas of disagreement is to determine if the government and contractor sides can mutually solve the problems that divide them. Mutual problem-solving involves attempts to overcome this conflict by agreeing to alternative solutions satisfactory to both parties.

For example, although most contractors want to own the technical data generated by their contract, this condition is generally unacceptable to the government. The government side wants the data available for competitive follow-on acquisitions while the contractor does not want to give competitors access to proprietary information. The seemingly unresolvable problem can often be worked out by contractual language that protects the rights of both parties.

**Agreement
Through
Tradeoffs**

It is not always possible to resolve conflicting positions by developing solutions that satisfy both sides. Some issues will involve differences on which neither side can agree because each side feels its position can be supported with logic and fact. When this occurs, the negotiators will have to attempt to reach agreement through the process of trading. Each party will have to make a concession that is important to its side. A concession made on one issue is traded by getting the other party to concede on a different issue.

- Skill is required in knowing how and when to make concessions. (Wise concession making is covered in Chapter 5.) Some skilled negotiators believe it is preferable to get the other side to make the first concession because the side that makes the first concession is often more likely to concede the most. Other good bargainers want to make the first concession to set the tone for a win/win environment which will, in turn, facilitate concessions from the other side.
- Counteroffers should be supportable and represent a reasonable government position. However, counteroffers should generally be somewhat conservative but still appear reasonable. Large concessions leave no room for further room for maneuvering. In addition, large numbers of small concessions will more likely demonstrate fairness and reasonableness than one or two large concessions.
- Provide sufficient justification to convincingly demonstrate the merits of the government position. Also give the contractor team time alone to review the government counter. Likewise, a recess after contractor counteroffers is often beneficial to enable the government to examine the merits of the new position. When necessary, seek advice from outside experts to prepare the next government offer.
- When a midpoint between the government and contractor position is acceptable, consider splitting the difference evenly. However, the difference between the two respective positions should be very small before the "split" occurs. Moreover, further bargaining on the issues should be avoided after a "split" has occurred. Efforts to continue more "splits" resemble auctions and are detrimental to negotiator credibility.
- When there are still some remaining issues, try to reach final agreement by combining the outstanding issues. When the unresolved issues represent a small part of the total deal, this technique may quickly bring a final resolution of all remaining issues. For example, this technique can be successfully applied when material costs and the profit remain unresolved by combining the issues and attempting to reach agreement on total price.
- Keep a written record of offers, counteroffers, agreements, and unresolved issues. This list can be helpful in showing what the positions were and what each side agreed to.

**Task 5:
Managing the
Team**

The chief negotiator, as government team leader during the negotiations, must know when to call on the members of the team. The lead negotiator must continually exercise the positive control necessary to ensure effective communications while presenting a unified position to the contractor side.

The chief negotiator must also be prepared to interrupt when team members become overeager and enter into an uncontrolled discussion with the contractor. For example, the lead negotiator might say "I'm going to interrupt you because I think we're getting off the track" or "I'm a little unclear on this point myself, and I'd like to discuss this privately with my team before we continue."

**Task 6: Taking
Breaks/Caucus**

Frequent breaks should be taken by the government side in order to control the pace of the negotiations and to ensure private team discussions. Breaks afford

the negotiation team time away from the conference table to privately assess new information and re-evaluate its position. Because of the lack of privacy, team caucuses should not be attempted in the negotiation conference room. Breaking in a separate area also permits the negotiation team to consult other individuals either in person or over the telephone without the other side knowing.

Breaks are generally called when one party wants to give the other side the opportunity to evaluate a position or concession. Caucuses are also used to restore team control when one team member has spoken out of turn. Use breaks to help restore a cordial and unemotional atmosphere when emotional or provocative statements are made, or to calm down individuals who have become contentious. In addition, breaks are extremely useful in providing refreshing relief from the stress of the negotiation. Any team members could also request a recess when an important point has been missed or if the chief negotiator did not take advantage of an opening that the contractor has provided.

Caucuses may help divert the discussion from sensitive issues or areas of weakness because the discussions resumed after the break do not always begin precisely where they ended. A skilled negotiator can often steer the ensuing discussion around the sensitive issues once the discussion resumes.

**Task 7:
Closing**

The negotiation should be closed as soon as possible once both sides reach general agreement. Do not prolong discussions any longer than necessary. Because the purpose of the bargaining session is to reach a deal, seize the moment by exhibiting your conviction that the agreement is at hand.

A wavering party that is uncertain that the deal is in its best interest may be swayed by assurances, such as, "What we have agreed to is in our mutual interests," or "I'm confident that we both have a good deal." When the other side is still reluctant, show anticipation that a deal has been reached by discussing the wording of the agreement. Focusing attention on your intent to enter into an agreement may provide the push needed for final acceptance. Discussions on the wording of the agreement could also be combined with questions about starting the project, such as "When would you like to begin work?"

Another way to close is to summarize the areas of mutual agreement and extend a handshake as a gesture of closure. In this regard, reviewing interim agreements on major portions of the contract may also be beneficial in obtaining final overall agreement.

4.3 Prepare the Price Negotiation Memorandum

The Need for Documentation

A negotiated contract pricing action must be supported by written evidence demonstrating that the price is fair and reasonable. This evidence must be in sufficient detail to record the significant considerations established in the negotiated contract price.

Reports of analyses and requests for specific information contribute to the factual basis for determining that the offered price is fair and reasonable. The Price Negotiation Memorandum (PNM), and supporting reports of analysis, are used in reviews preceding approval of the proposed contract and in future acquisitions. Because of the number of contract actions, contracting personnel turnover, or the use of contract files in historical research, this memorandum must permit a rapid reconstruction of the major considerations in pricing the contract.

Price Negotiation Memorandum (PNM)

The official contract file must include written documents demonstrating, clearly and conclusively, what was agreed to in regards to price, terms and conditions, schedule, and work requirements. The documents must show all significant facts considered in reaching agreement with the contractor.

After negotiations have been concluded, the contracting officer must document the results of the negotiation and tell the story of the negotiation using the format of the PNM prescribed for your contracting activity. The following questions that must be addressed by the PNM are listed in FAR 15.808.

FAR 15.808

- What was the offer and what were the costs in the SF 1411?
- What was the government price objective and what were the costs supporting that goal?
- What cost or pricing data were submitted but not relied on and not used?
- What were the goals as to delivery and pricing arrangement?
- What was discussed?
- What were the compelling arguments?
- What disposition was made of the principal points raised in preliminary analyses, included in the objective, and discussed in the negotiations?
- What cost values support the agreed-to price?
- If different from those supporting the objective, what justifications are there for the differences?

The PNM is also used as a sales document to establish the reasonableness of the agreement reached with the company. This document is the permanent record of the negotiation that charts the progress from proposal through agreement. The

PNM is the source document when it becomes necessary to reconstruct the events of the procurement. A written record is also needed because the members of the negotiating team may either not remember or not be available when questions are raised.

PNMs are written by the CO or a representative from the negotiating team. Depending upon the organization, this may be the price analyst or contract negotiator. In any event, it should be an individual who actively participated in negotiation of the pricing arrangement.

Among the data generated by the end of the negotiation are:

- The price proposal
- Supporting schedules
- Subcontractor cost or pricing data
- Revised and supplementary data

Additional data will be from the government personnel who provided supporting analyses. Collectively, the documentation should show what data were available.

The PNM explains the data, including:

- The identification of significant factual data
- Explanation of how the facts influenced estimates of costs
- Which factors persuaded the negotiator that a specific figure was the one to use

The PNM will also show factual data submitted and not used, and specifically identify any cost or pricing data found to be inaccurate, incomplete, or not current.

The question of length is a critical one, because it is very easy to go into great detail in reporting the events of an extended negotiation. The writer must guard against excessive detail, and perhaps just as importantly, against using jargon. The level of detail and style in the PNM is determined by the audience of the document, which generally consists of the government officials who have the final say on whether the contract is approved.

The differences in the level of PNM detail and complexity is often caused by the amount of actual cost and performance data available and relevant to the negotiation. The availability of data will shape the course of analysis and dictate the kind and amounts of information to include in the PNM. The existence of meaningful actual costs should make it possible to be quite precise in explaining what was done and why it made good sense to do it.

FAR 15.808(a) The PNM format as extracted from FAR 15.808(a) is provided as supplemental information:

- The purpose of the negotiation
- A description of the acquisition, including appropriate identifying numbers
- The name, position, and organization of each person representing the contractor and the government in the negotiation.

If certified cost or pricing data were required, the extent to which the contracting

officer:

- Relied on the cost or pricing data submitted and used them in negotiating the price; and
- Recognized as inaccurate, incomplete, or not current any cost or pricing data submitted; the action taken by the contracting officer and the contractor as a result; and the effect of the defective data on the price negotiated.

A summary of the contractor's proposal contains the field pricing report recommendations, and the reasons for any pertinent variances from these recommendations. Where the determination of price reasonableness is based on cost analysis, the summary shall address the amount of each major cost element:

- Proposed by the contractor
- Recommended by the field or other pricing assistance report (if any)
- Contained in the government's negotiation objective
- Considered negotiated as a part of the price

The most significant facts or circumstances controlling the establishment of the prenegotiation price objective and the negotiated price including an explanation of any significant differences between the two positions. To the extent such direction is received, the PNM shall discuss and quantify the impact of direction given by Congress, other agencies, and higher level officials if the direction has had a significant impact on the action.

4.4 Summary

Summary

Careful adherence to appropriate conduct of government contract negotiations helps ensure a fair and reasonable price for the government and contractor sides. Proper negotiation conduct begins with the preparation of the negotiating environment and the personal introductions at the start of the bargaining session. During the negotiations, the government negotiator can use a variety of bargaining methods to resolve conflict and reach agreement. But throughout the bargaining session, the chief negotiator should focus on using logic and persuasion to present the government position. A win/win outcome beneficial to both sides is more important to the government than obtaining the contract at the lowest possible price. Finally, the PNM should clearly document how the price was derived by showing what facts were considered in reaching agreement with the contractor.
